

New SEC Staff Legal Bulletin Shifts Burden to Boards on Ordinary Business and Economic Relevance Exclusions, Clarifies Proposal by Proxy and Retains Status Quo on Use of Images

November 2, 2017 | Client Update | 4-minute read

Yesterday, the SEC Staff issued a new [Staff Legal Bulletin \(SLB\)](#) on shareholder proposals. The most striking impact it will likely have initially is on the ordinary business exclusion, Rule 14a-8(i)(7), as the SLB requires boards to undertake the responsibility to analyze proposals. It appears that the SLB is effective immediately.

Ordinary Business. A long line of no-action letter precedents provides guidance on which proposal topics constitute ordinary business, and therefore need not be included in the proxy statement, as opposed to those that must be voted on because they focus on significant policy issues that transcend ordinary business. For example, proposals related to environmental matters or executive compensation are generally considered weighty policy matters and not ordinary business. Recent proposals that were excluded based on ordinary business include those that sought reports on minimum wage reform, drug pricing and the use of virtual meetings. Other common topics where the SEC Staff agreed with companies include ones that questioned companies' choice of products or services to sell, or touched on litigation strategies. The SEC Staff did not permit exclusion in many other cases, however. Last season, Rule 14a-8(i)(7) was the most common argument denied.

The SLB indicates that instead of having the SEC Staff make these "difficult judgment calls," boards should be held responsible because they are "well suited to analyze, determine and explain" whether a particular issue is sufficiently significant as a social policy matter. A company making a no-action letter request under Rule 14a-8(i)(7) will need to include a discussion that reflects the board's analysis of the particular policy issue raised and its significance. The SLB notes that this would be most helpful if it "detailed the specific processes employed by the board to ensure that its conclusions are well-informed and well-reasoned."

There are a lot of open questions on how this SLB will apply in practice. At the moment it appears that in every situation when a company wants to use the ordinary business exception, a board must develop a process to analyze the proposal and explain that it does not have a social policy significance, even if a long line of precedents have already made this determination. To take two current albeit extreme examples, a proposal at Luby's Cafeteria to change the company name and another to the landlord of the Empire State Building to provide shareholders with free tickets would both require board processes that the SEC staff views to be "well-informed and well-reasoned," in order for those companies to argue that neither request is socially significant.

It is unclear whether the fact that the SEC Staff has long made the same determination for similar proposals can be, or should be, relied on by boards as part of their processes. Also, presumably companies are not limited to examining the same factors that the SEC Staff has historically looked to, namely whether the topic has received attention in the public domain or by lawmakers for possible legislation. Instead, it may be that a company can decide on analysis of other factors that it believes are more relevant to its business. Another meaningful challenge for companies will be the timing of trying to schedule the board reviews of proposals within pre-existing meeting schedules before the deadline for no-action letters.

There is also a question of whether this suggests, as it seems to, that long-standing topics like environmental matters and executive compensation now can also be argued under company-specific facts and board determinations that those proposals are ordinary business matters, instead of being assumed to be social policy issues in all cases. Companies may be able to draw distinctions based on different types of environmental proposals and the specific requests. Also, a proposal that simply refers to executive compensation although the central issue is about proxy voting tallies, like we saw earlier this year, may no longer be deemed to be a social policy issue.

Economic Relevance. Companies have not relied on 14a-8(i)(5) because few proposals have ever been excluded on this basis, even when the topic represents less than 5% of a company's assets, earnings or sales, since the SEC Staff must also consider whether the proposal "is not otherwise significantly related to the company's business."

In the SLB, the SEC Staff has again decided that a board is in the best position to make this judgement. Like the ordinary business analysis, a company's Rule 14a-8(i)(5) no-action request must include a discussion that reflects a board's analysis of the proposal's significance to the company. Again, it should include details of the "specific processes employed by the board to ensure that its conclusions are well-informed and well-reasoned."

Proposal by Proxy. Going forward, a proposal submitted by a representative to a shareholder must include documentation that includes identification of: (a) the shareholder-proponent and the person or entity selected as the proxy; (b) the company; and (c) the specific proposal to be submitted. The documentation must also be signed and dated by the shareholder. Otherwise, the proposal may be excludable under Rule 14a-8(b).

Use of Images. The SLB states that the use of images in a proposal can only be covered under the 500-words test if the total number of words in the proposal, including words in the graphics, exceeds 500. It notes that graphics or images may be excludable under the argument that they are vague or misleading under Rule 14a-8(i)(3) if they fit the criteria in that test.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

Ning Chiu

+1 212 450 4908

ning.chiu@davispolk.com

This communication, which we believe may be of interest to our clients and friends of the firm, is for general information only. It is not a full analysis of the matters presented and should not be relied upon as legal advice. This may be considered attorney advertising in some jurisdictions. Please refer to the firm's privacy notice for further details.